In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-764

JAMES GRADY WALLER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

After a jury trial in the United States District Court for the Eastern District of Texas, petitioner was convicted on two counts of having willfully made and subscribed individual income tax returns which he did not believe to be true and correct as to every material matter, in violation of 26 U.S.C. 7206(1) (R. 7-10).[1] He was sentenced to two consecutive 18-month prison terms, with immediate parole eligibility under 18 U.S.C. 4208(a)(2) (R. 65-66).

Petitioner owned a controlling interest in the Crockett National Life Insurance Company and the State National Bank of Lovelady (Pet. 3). He also

[1] "R." refers to the appendix filed in the court of appeals.

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operated the Waller Funeral Home as a sole proprietorship. After substantial evidence had been introduced showing that petitioner's income tax returns had understated the income of the funeral home, an expert witness testified for the government that in his opinion the total of such understatements for the two prosecution years, 1966 and 1967, was $21,018 (R. 1468–1508) and $24,027 (R. 1509–1528), respectively.[2] Although the understatements of income from the funeral home constituted the bulk of the government's proof, there was also evidence to show that petitioner had received disbursements and indirect payments from the two corporations which he controlled, the Crockett National Life Insurance Company and the State National Bank of Lovelady, without reporting those items as income (R. 1536–1553).[3]

1. There is no substance in the argument (Pet. 8–12) that the evidence relating to the corporate distributions, or "constructive dividends," should not have gone to the jury. After the expert witness explained in detail the meaning of the phrase "constructive

[2] The understatements resulted from the omission of several individual items of income. Petitioner admitted on the witness stand that he had not brought these omissions to the attention of the accountant who prepared the tax returns and that he had instructed his bookkeeper not to record these items (R. 1686–1689, 1777, 1796).

[3] Non-salary distributions of this kind, when made to corporate shareholders, constitute taxable dividends to the extent that they are paid out of earnings and profits (see *e.g.*, *Regensburg* v. *Commissioner*, 144 F. 2d 41 (C.A. 2)), and the evidence established that petitioner's corporations had sufficient earnings and profits to cover the distributions made to him (R. 1348–1377, 1540).

dividends," defense counsel stated that he had no objection to further testimony on that issue provided that the court would, in its instructions, define what legally constitutes a constructive dividend (R. 1532). Such instructions were given (R. 2017–2019).

Petitioner is incorrect in now suggesting (Pet. 9) that proof of constructive dividends is appropriate only in civil tax cases and has not been used in criminal cases. Many criminal tax convictions have rested entirely, and others primarily, on proof of the receipt of unreported constructive dividends. See, *e.g.*, *United States* v. *Wallace*, 300 F. 2d 525 (C.A. 4); *United States* v. *Keenan*, 267 F. 2d 118 (C.A. 7), certiorari denied, 361 U.S. 863; *Currier* v. *United States*, 166 F. 2d 346 (C.A. 1). Whether petitioner knew that his constructive dividends should have been reported on his tax returns was a question of fact for the jury, and petitioner does not contend that the jury was improperly instructed as to this question.[4]

2. Petitioner contends (Pet. 12–14) that the government's evidence pertaining to his banking practices was irrelevant and prejudicial. The proof showed that even though petitioner did not have an account in his name or in the name of the Waller Funeral Home at

[4] Petitioner does contend (Pet. 9–10) that the forgiveness by the Bank of a particular note was not income to him because he had not been liable on the note or, alternatively, that it had not been established that he had received an initial benefit for incurring the liability. But there was ample evidence that he was personally liable (R. 1328–1333, 1337–1339, 1533), and in the absence of evidence to the contrary the jury could reasonably infer that a benefit had been received in exchange for incurring the liability.

the Farmers Guaranty State Bank at Kennard (R. 211, 258), he made a practice, throughout the prosecution years, of writing checks on that bank as though he did have such an account (R. 256–260). The bank would hold these checks as cash items and then within a few days petitioner would redeem them, either with third party checks (usually checks written to the funeral home for professional services) or with cash (R. 256–260). The president of the bank testified that when a person writes a check against an account that does not exist, it is not an overdraft but a "hot check" (R. 258) and that the checks written by petitioner were in fact "hot checks," although the bank, knowing petitioner, nevertheless honored them (R. 259).

This banking practice facilitated petitioner's concealment of taxable income: the checks payable to the Waller Funeral Home used to redeem the "hot checks" represented, at least in part, items of income which petitioner instructed his bookkeeper not to record (see note 2, *supra*); by using these checks to redeem his "hot checks," petitioner prevented them from being recorded as a deposit to his own bank account and thereby hampered detection of the understatements on his returns.[3] Thus evidence of this practice was probative on the issue of willfulness; it showed that petitioner was handling his "affairs to avoid making the

[3] Some of the "hot checks" were admitted in evidence without objection by the defense (R. 186). Petitioner had admittedly destroyed others after they were redeemed (R. 1755). One hundred and seven checks paid in redemption of the "hot checks" were admitted in evidence without objection (R. 202–260).

records usual in transactions of the kind." *Spies* v. *United States*, 317 U.S. 492, 499.

3. There is no merit to petitioner's final contention (Pet. 14–16), that the government's expert witness should not have been permitted to express his opinion on nonaccounting issues. All such issues pertained to questions relating to taxation and the witness was qualified without objection to testify as an "expert witness in the income tax field" (R. 1464). Such witnesses are allowed wide latitude in criminal tax cases, as are experts testifying for the defense. *United States* v. *Johnson*, 319 U.S. 503, 519–520. But this witness, contrary to petitioner's suggestion (Pet. 15–16), did not state his conclusions on the whole case; it was left to the jury to resolve whether petitioner had been willful in understating his taxable income, and the witness expressed no opinion on that question.[6]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ERWIN N. GRISWOLD,
Solicitor General.

JANUARY 1973.

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[6] See, generally, Rule 704 of the new Federal Rules of Evidence: "Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact."

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